SUMMARY – INTERCARRIER COMPENSATION ISSUES AND POTENTIAL SOLUTIONS

1. ***BASIS OF INTERCARRIER COMPENSATION***:

   The Service Provider (IXC, Wireless Provider, RBOC, LEC, etc.) charges the customer for the service it provides and uses those revenues to recover its costs and to pay all carriers for the use of their facilities utilized by the service provider to complete its customers' calls.

   - An input to a service (network costs) should be paid for by a service provider.

2. ***CHARACTERISTICS OF RURAL LECs:***
   - Low density resulting in high costs with a significant portion of the costs recovered from intercarrier compensation (See Tab 2).
   - The rural LEC network is used by many providers to originate and to terminate their customers' traffic. For many rural LECs, much of this traffic is delivered to the rural LECs via a third party network provider (likely the RBOC). (See Tab 3 for the types of traffic terminated by rural LECs).
   - Cellular (wireless) traffic is significant and growing. There is a significant imbalance in traffic terminated by CMRS carriers on the rural LECs' networks and the traffic terminated by rural LECs on the CMRS carriers' networks. (See Tab 4).
   - Rural LEC traffic sensitive costs per minute are available. If a unitary rate is adopted and current Intercarrier Compensation revenues are reduced, the revenue shortfall must be recovered from a support fund. (See Tab 5 for an example calculation).
   - Uncompensated phantom traffic for rural LECs (traffic with no CPN or carrier identifier or CIC) may be relatively small. (See Tab 3 for an example).

3. ***ISSUES INVOLVING THE CURRENT INTERCARRIER COMPENSATION SYSTEM*:**

a) Incorrect assertions that Bill-and-Keep is appropriate:

- CMRS carriers *claim that traffic is balanced* with LECs.
- IXCs incorrectly *claim that interexchange costs are largely subsidies*.

b) Differing Intercarrier Compensation rate levels for essentially the same service:

- *Differing Interstate and Intrastate access rate levels* – Interstate (2-3 cents per minute; Intrastate (rates ranging from 2 cents to over 6 cents per minute).
- *Differing local (reciprocal compensation) versus toll (access) compensation rate levels.*
  - Driven by differing basis for rates – Reciprocal compensation (arbitrated rates based on forward-looking costs or negotiated rates); Access (tariffed, embedded or actual costs).
- *Imposition of a differing definition of local and access calling area for Cellular traffic versus IXC/LEC/CLEC traffic.*
  - Cellular local calling area is the MTA, while IXC/LEC/CLEC is traditional LEC local calling area as tariffed by the State Commission.
  - For local traffic, the LEC or CMRS carrier or CLEC is presumed to be the service provider and the traffic is subject to reciprocal compensation, while for toll, the toll carrier is the service provider and access charges are applied.
  - Typically, arbitrated or negotiated reciprocal compensation rates are lower than access charges.
- *Access charge exemption for alleged nacient services.*
  - ESP/ISP Exemption - Use of a flat-rated local business rate rather than access – For large volumes of traffic, much lower effective per-minute rate than either reciprocal compensation or access charges.
  - Claims that all IP traffic is (VOIP Traffic) is subject to the exemption.

- *LEC Expanded Area Services (EAS).*
  - EAS local calling areas historically established in response to customer community of interest calling patterns (customer demand or often politically imposed).
  - Customer rates historically flat rate additions to basic local service.
  - Intercarrier compensation for EAS - Bill and Keep if traffic roughly balanced and costs similar; or Bill and Keep for switching if traffic roughly balanced, but transport cost differences recognized; or usage based, but with a cap to insure that compensation does not substantially exceed retail revenues received, etc.
  - Where EAS arrangements were imposed, in order to maintain reasonable retail rate additives for the expanded local service, intercarrier compensation shortfalls may be included in State support funds.

c) Arbitrage due to differing compensation rate levels:

- *Regulatory driven arbitrage due to rules applying differing compensation regimes* (Interstate versus state access; access versus reciprocal compensation; MTA versus LEC local calling area; ESP/ISP exemption).
  - Advantages certain retail providers at the expense of others – CMRS carriers have lower compensation costs for calling within the MTA than IXCs; ESPs pay a much lower effective compensation rate than either CMRS carriers or IXCs or LECs.
  - Results in loss of compensation revenues by LECs that were used maintain and upgrade the network.
  - Results in a compensation system that is not competitively or technologically neutral, nor one that provides sufficient and predictable revenue, contrary to the Telecom Act, as amended in 1996.

- *Inappropriately driven arbitrage by retail service providers seeking to pay the lowest compensation rate.*
    - CMRS carriers' failure to negotiate termination agreements with rural LECs when delivering traffic via a third party network (typically the RBOC) – free termination or effective Bill and Keep rather than payment of reciprocal compensation.
    - Masquerading traffic as local rather than access – Worldcom/MCI; AT&T VOIP – terminating access traffic handed off to a CLEC or an ESP in order to pay local compensation or no compensation rather than access.
    - Reporting Intrastate access traffic as Interstate access in order to pay lower Interstate access rates.
    - Stripping the Calling Party Number (CPN) and/or Carrier Code so that the originating retail carrier cannot be identified by the terminating network provider. The terminating carrier consequently does not know whom to bill or what to bill (access or reciprocal compensation) for the terminating minutes.
    - Etc.

d) Administrative difficulties with the current regime.

- *Difficulty in negotiating reciprocal compensation*.
    - Many LECs, CMRS carriers and CLECs with whom compensation must be negotiated or arbitrated – cost of negotiations or State Commission arbitration proceedings.
    - No established forward-looking cost standard – complicated disputes over model inputs, appropriate cost levels, etc.
    - Etc.
- *Confusion about which rate should be applied* (access or reciprocal compensation) complicated and legally tortured FCC rules – multitudes of petitions and requests for declaratory rulings.

- *LECs required to add terminating measurement capabilities to police the system, thereby increasing costs.*
  - Percent Interstate Use (PIU) for access appropriate?
  - Is the traffic access or local and subject to reciprocal compensation?
  - Who is the originating carrier that should be billed?
  - What is the balance of traffic for local reciprocal compensation?
  - Etc.

4. ***POTENTIAL SOLUTIONS:***

a) **Basis for choosing a revised Intercarrier Compensation plan:**

- Does the solution eliminate or minimize arbitrage?
- Is the solution cost causative or economically efficient?
- Is the solution simple, does it minimize the current administrative problems and does it provide a smooth transition from the current compensation process (minimize discontinuities or abrupt changes)?
- Is the solution equitable for consumers, retail service providers and to providers of network facilities throughout the country?
- Does the solution maintain existing Federal and State jurisdictions?
- Does the solution provide sufficient, sustainable and predictable revenues as required by the Act for the network providers to recover the costs of maintaining and upgrading networks that all retail service providers use?
- Is the solution competitively neutral?
- Is the solution technologically neutral?

b) **Evaluation of currently proposed plans:**

- Tab 6 contains a high level comparison (based on FWA's understanding of the plans) of various publicly available plans or positions.
- *Major flaws with certain plans*:

- Bill and Keep is only economically appropriate when traffic is roughly balanced between service providers (i.e., approximately 50/50)[1] and termination costs are approximately the same. Rural LEC traffic is not roughly balanced with wireless carriers or with CLECs' use of Rural LECs' networks. Consumers of a product (retail interexchange service providers-IXCs/CMRS/CLECs/VOIP) should pay for the interexchange network resources utilized and not expect other services or products (local service) to subsidize their retail interexchange services.
- Bill and Keep is inappropriate for IXC services because IXCs use LEC facilities to originate and terminate their customers' traffic while LECs do not use IXC facilities for their services.
- Bill and Keep provides no constraint on the uneconomic imposition of additional (and unrecoverable) network costs by retail service providers on network facility providers.
- Capacity-based plans charge network termination costs to the third party carrier and not to the retail provider of the service. The plan does not appear to provide a method of recovery from retail service providers for common (FGC) trunk group costs that are utilized by multiple retail service providers.
- There is no economic justification for a declining intercarrier compensation rate as proposed by NASUCA.

- *Areas of Commonality – Most plans propose*:
  - A unified rate to eliminate or mitigate most current arbitrage.
  - Continuation of MOU/current structure initially or permanently for circuit switched interconnection.
  - Initially, or permanently that the retail service provider pay for the network facilities used.
  - That all retail service providers pay the unified rate.

[1] For every minute originated by a CMRS provider's customer and terminated by an ILEC, a minute is originated by an ILEC customer and terminated by a CMRS provider.

- A revenue neutral fund to deal with the revenue reductions caused by the proposed compensation plan.
- Non-portable funding for unrecovered costs.

- *Major Differences*:
  - Basis for establishing unitary MOU rate – embedded costs, TELRIC or current Interstate rates.
  - Jurisdiction over Intercarrier Compensation and resulting access restructure funds.
  - New structure – is a major overhaul required for circuit switched (EPG-capacity plan) or is a new measuring system required for IP (ARIC)?
  - Necessity for local and SLC rebalancing – to what extent?
  - Revenue neutrality for restructure funding.

c) Changes that are necessary in the near term:

- Eliminate or minimize most arbitrage - A unitary rate for access and reciprocal compensation and application of that rate to all retail service provider traffic that uses LEC network facilities, including phone-to-phone or computer-to-phone VOIP services.
- Insure that ESPs or ISPs cannot utilize their exemption to terminate calls to the circuit switched network.
- If feasible, insure nationwide equity between States and customers – Possibly implement a benchmark local rate (nationwide RBOC level). Recover a portion of the revenue shortfall created by the unitary rate from increases to the local rate benchmark, where rates are below that benchmark.
- Recover the remainder of the revenue shortfall from an access recovery fund or state equalization fund. Funding to be shared by both the Federal and State jurisdictions.

- It may be unnecessary now to consider major discontinuities such as capacity-based charges because unrecoverable phantom traffic levels appear to be small. A more appropriate and less disruptive change would be to require carriers to send with all calls, all data necessary to identify the originating retail service provider (CPN, carrier code, etc.).
- It is unnecessary now to adopt changes for IP broadband provider compensation, except when those providers utilize the circuit switched network to originate or to terminate calls. Time should be taken to determine how to properly apply intercarrier compensation to pure IP broadband calls.

Final Thoughts - Incremental change that deals with the major problems (arbitrage) and that provides continuity with the current compensation regime will provide stability and certainty to the industry. If a major change is implemented, it should be slowly transitioned into place and evaluated each year to insure that it accomplishes the intended purpose.